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IN THE

Supreme Court of the United States

October Term, 1949

No. 617

COMMONWEALTH OF PENNSYLVANIA,
Petitioner

vs.

THE CURTIS PUBLISHING COMPANY,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA AND BRIEF IN SUPPORT THEREOF

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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1949

No.

Commonwealth of Pennsylvania,
Petitioner

vs.

The Curtis Publishing Company,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner respectfully prays that a writ of **certiorari** issue to review the judgment of the Supreme Court of Pennsylvania, reported in 363 Pa. 299 (1949), which affirmed a judgment of the Common Pleas Court of Dauphin County reported in 59 Dauph. 430 (1948) (R. 140a, 153a).

I. SUMMARY OF STATEMENT OF MATTER INVOLVED

Respondent, The Curtis Publishing Company of Pennsylvania, is a Pennsylvania corporation, and, during the year 1942, was engaged in business in the Commonwealth of Pennsylvania.

Pursuant to the Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, Respondent, on April 5, 1943, filed its corporate net income tax return for the calendar year 1942 wherein the tax estimated by it to be due was "None", based upon its net income as returned to the Federal Government. Following an adjustment by the Federal Government of its Federal net income for the year 1942, Respondent filed with the Commonwealth of Pennsylvania a Report of Change which reported that its adjusted net income as returned to and ascertained by the Federal Government increased from $886,280.53 to $1,033,923.16.

Included in Respondent's changed net income as returned to and ascertained by the Federal Government was an item of $75,389.62, representing interest on United States obligations issued subsequent to March 1, 1941, subject to Federal income tax, following the enactment of the Federal Public Debt Act of February 19, 1941, Chapter 7, Section 4, 55 Stat. 9.

In arriving at Respondent's net income tax base for purposes of the state tax, the fiscal officers of the Commonwealth deducted from Respondent's reported Federal net income, as prescribed by the Pennsylvania statute, the amount of Federal taxes paid and the amount of dividends received by Respondent as owners of shares of stock in other corporations. The item of $75,389.62 representing interest on United States obligations issued after March 1, 1941, was not deducted from Respondent's net income as returned to and ascertained by the Federal Government. The allocation fractions prescribed by the Pennsylvania statute were then applied to the resultant net income tax base to arrive at Respondent's corporate net income tax liability to the Commonwealth in the amount of $6,367.67.

Respondent contends, and Petitioner denies, that by reason of the Commonwealth's refusal to deduct interest on United States obligations issued after March 1, 1941, from Respondent's tax base measured by net income as returned to and ascertained by the Federal Government, the Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, has been applied in violation of Article VI, Clause 2, and Article I, Section 8, Clause 2, of the Constitution of the United States.

II. STATEMENT AS TO JURISDICTION

A. Basis upon which it is contended that the Supreme Court of the United States has jurisdiction on Writ of Certiorari to review the judgment in question.

The judgment of the Supreme Court of Pennsylvania, a review of which is sought by this petition for a writ of certiorari, was dated and filed on November 22, 1949. It is a final judgment in a suit in the highest court of the Commonwealth of Pennsylvania in which a decision in the suit could be had. In this suit, there was drawn in question the validity of a statute of the Commonwealth of Pennsylvania in its application to Respondent on the grounds of being repugnant to Article VI, Clause 2, and Article I, Section 8, Clause 2, of the Constitution of the United States. A decision on this case was necessary to the determination of the case, and the decision was against the validity of the statute.

B. Statutory provision and cases believed to sustain jurisdiction.

The statutory provision believed to sustain the jurisdiction of the Supreme Court of the United

States upon petition for review of the judgment in question on writ of certiorari is Title 28 United States Code, Section 1257 (3), Act of June 25, 1948, C. 646, 62 Stat. 869. Cases believed to sustain jurisdiction are **McGoldrick v. Gulf Oil Corp.**, 308 U. S. 545 (1939) and **Nelson (Rodewig) v. Sears, Roebuck and Co.**, 311 U. S. 630 (1940).

C. The statute of the Commonwealth of Pennsylvania, the validity of which is involved.

The statute of the Commonwealth of Pennsylvania which was held as applied to Respondent to be repugnant to Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States is the Act of May 29, 1941, P. L. 62, reenacting and amending the Act of May 16, 1935, P. L. 208. The following are the relevant provisions of this Act.

Section 3 of the said Act provides:

> "Every corporation shall be subject to, and shall pay for the privilege of doing business in this Commonwealth, or having capital or property employed or used in this Commonwealth * * * a State excise tax * * * at the rate of seven per centum per annum upon each dollar of net income of such cor-

porations during the calendar year(s) * * * one thousand nine hundred forty-two * * *."

Section 2 of the Act defines net income as follows:

"'Net Income.' 1. In case the entire business of the corporation is transacted within this Commonwealth, net income for the calendar year or fiscal year as returned to and ascertained by the Federal Government, subject, however, to any correction thereof, for fraud, evasion, or error as finally ascertained by the Federal Government: Provided, That additional deductions shall be allowed from net income on account of any Federal taxes paid during such calendar or fiscal year for the preceding calendar or fiscal year, or accrued during such calendar or fiscal year for such year, as the case may be, and on account of any dividends received from any other corporation: * * *

"2. In case the entire business of any corporation, other than a corporation engaged in doing business as an insurance or surety company, is not transacted within this Commonwealth, the tax imposed by this act shall be based upon such portion of the net income of such corporation for the fiscal or calendar year, as defined in clause one hereof, as may be determined by allocations and apportionment made as follows * * *"

Section 2 of the said Act then provides for the allocation or non-allocation of capital gains and for the computation of the taxable portion of the resultant net income by the application of a formula made up of three fractions consisting of tangible property, payroll and receipts, the elements of which are set forth in detail in the Act.

D. Date of the judgment sought to be reviewed and of petition for review on Writ of Certiorari.

The judgment of the Supreme Court of Pennsylvania sought to be reviewed was dated and filed on November 22, 1949.

This petition is presented within ninety days of that date.

E. Statement showing that the nature of the case and the rulings of the court were such as to bring the case within the jurisdictional provisions relied upon.

As set forth in Statement I, above, (Summary Statement of Matter Involved), the fiscal officers of the Commonwealth settled Respondent's corporate net income tax liability for the year 1942 at $6,367.67. In arriving at this settlement no deduction was allowed for interest received by Re-

spondent on United States obligations issued after March 1, 1941, since such interest was included in Respondent's net income as returned to and ascertained by the Federal Government for Federal tax purposes.

Respondent thereupon filed an appeal in the Court of Common Pleas of Dauphin County, Pennsylvania, in which it contended, inter alia, that the settlement of the tax, and the Act of May 29, 1941, P. L. 62, under the authority of which said settlement had been made, were repugnant to the Constitution of the United States, because:

1. The effect of the tax imposed as settled was to infringe upon the sovereignty of the United States in violation of Article VI, Clause 2, of the Constitution of the United States.

2. The effect of the tax imposed was to discriminate in favor of interest received from, and in favor of, obligations of the Commonwealth of Pennsylvania and its political subdivisions; and against the interest received from, and against the securities of the United States; and

3. The effect of the tax imposed was to burden, restrict, impede and interfere with the power of Congress to borrow money in violation of the provisions of Article I, Sec-

tion 8, Clause 2, of the Constitution of the United States.

The trial court determined the amount of tax owing by Respondent to be $2,549.01; sustained the contentions made by Respondent, and refused those of Petitioner made in denial thereof; and held that the Act of May 29, 1941, P. L. 62, as applied to Respondent by the Commonwealth's tax settlement violated Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States.

On appeal to the Supreme Court of Pennsylvania from the findings, conclusions, rulings and judgment of the trial court, Petitioner made the same contentions as before the trial court. In affirming the judgment of the trial court, the Supreme Court of Pennsylvania overruled each contention made by Petitioner and held the Act of May 29, 1941, P. L. 62, as applied to Respondent by the Commonwealth's tax settlement to be repugnant to and in violation of Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States.

F. The stage in the proceedings in the court of first instance and in the appellate court, in which the federal questions sought to be reviewed were raised; the method of raising them and the way in which they were passed upon by the court; the rulings of the court thereon to show that the case is brought within the statutory provisions believed to confer jurisdiction on this court.

The questions as stated above were raised by Respondent in the 11th, 12th and 14th paragraphs of its Appeal and Specification of Objections filed with the trial court (R. 7a, 8a) and more fully stated in Respondent's 1st, 3rd and 5th Requests to the trial court for Conclusions of Law (R. 99a, 100a, 101a) which read as follows:

> "1. A State tax which discriminates against United States securities is unconstitutional and void, as being in violation of Article VI, Clause 2, of the Constitution of the United States, which establishes the Constitution and the laws of the United States as the supreme law of the land, and as being in violation of Article I, Section 8, Clause 2, of said Constitution, which grants to Congress the power to borrow money."
>
> "3. The application which the Commonwealth of Pennsylvania has given the Cor-

porate Net Income Tax Act for the years 1941 and 1942, by which 'adjusted net income', as derived under the Federal corporation income tax return, is used as the base for computing the Pennsylvania corporate net income tax, results in such discrimination against United States securities as to render this application of the Act unconstitutional and void, because it operates to include interest received on United States securities issued on or after March 1, 1941, in the income subjected to the Pennsylvania tax, while interest on State and municipal securities is excluded from such income."

"5. A State tax measured by corporate net income which is computed by including interest on United States securities in the taxable income and by excluding interest on State and municipal securities and dividends on corporate shares from such income, discriminates against United States securities and is unconstitutional and void."

The same questions were raised by Petitioner in its 8th Request to the trial court for Conclusions of Law (R. 110a) as follows:

"(8) The inclusion of interest from obligations of the United States, issued after March 1, 1941, in the measure of the Pennsylvania Corporate Net Income Tax, is a valid exercise of the Commonwealth's right

to classify property for purposes of taxation and does not constitute unlawful discrimination against these securities in violation of either Article I, Section 8, Clause 2 or Article VI, Clause 2 of the Federal Constitution."

Petitioner urged these questions in its exceptions to the rulings on conclusions of law, conclusions of law, opinion and judgment nisi of the trial court (R. 141a) and in its assignments of error, brief and argument in the Supreme Court of Pennsylvania.

Respondent's above Requests for Conclusions of Law were specifically affirmed and Petitioner's Requests specifically refused by the trial court.

The tax statute as applied to Respondent was held to be in violation of Article I, Section 8, Clause 2, and Article VI, Clause 2, of the Constitution of the United States by the trial court in its opinion (R. 111a, 134a, 135a) in its affirmance of Conclusions of Law as requested by Respondent (R. 99a, 100a, 101a), in its refusal to find the Conclusions of Law requested by Petitioner (R. 110a) and in overruling Petitioner's exceptions to its conclusions of law, its opinion and judgment nisi (R. 153a); and by the Supreme Court of Pennsylvania in its opinion affirming the judgment of the trial court.

III. QUESTION PRESENTED

Where the Petitioner's fiscal officers settled Respondent's corporate net income tax account for the year 1942 upon a tax base measured by Respondent's "net income as returned to, and ascertained by the Federal Government" under the express provisions of the Act of May 16, 1935, P. L. 208, as reenacted and amended by the Act of May 29, 1941, P. L. 62, and where, in the absence of any statutory provision permitting or requiring it, neither the Respondent nor the fiscal officers deducted from such measure interest returned to the Federal Government as income on United States obligations issued after March 1, 1941, and owned by Respondent, does the settlement as made violate the Constitution of the United States, and particularly Article VI, Clause 2, and/or Article I, Section 8, Clause 2, thereof?

IV. REASONS RELIED UPON FOR THE ALLOWANCE OF A WRIT OF CERTIORARI

In denying the power of the Commonwealth of Pennsylvania to impose a corporate net income tax upon Respondent measured by its net income as returned to and ascertained by the Federal Government without deduction of interest on United States obligations issued after March 1, 1941, as being in violation of the Constitution of the United States, and particularly Article I, Section 8, Clause 2, and Article VI, Clause 2, thereof, the Supreme Court of Pennsylvania has decided a federal question of substance and importance which has not heretofore been determined by this Court, and in a manner probably not in accord with the applicable decisions of this Court, as indicated in the Brief in Support of Petition for Writ of Certiorari annexed hereto.

At least two other states have enacted corporate net income tax statutes with provisions similar to the Pennsylvania Corporate Net Income Tax Act—Massachusetts (General Laws C. 63, as amended, Section 30), and Vermont (Vermont Statutes, Revision of 1947, No. 15, Section 1).

V. PRAYER

Wherefore, your Petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Court directed to the Supreme Court of Pennsylvania, commanding that Court to certify and send to this Court, on a day certain to be named therein, a full and complete transcript of the record of the proceedings in case numbered 7, May Term, 1949, entitled on its docket "Commonwealth of Pennsylvania, Appellant v. The Curtis Publishing Company" to the end that the cause may be reviewed and determined by this Court as provided by law, that the judgment may be reversed, and for such other and further relief as may be appropriately granted in the premises.

Respectfully submitted,
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State Capitol,
Harrisburg, Pennsylvania.

IN THE
SUPREME COURT OF THE UNITED
STATES

October Term, 1949 **No.**

Commonwealth of Pennsylvania,
Petitioner

vs.

The Curtis Publishing Company,
Respondent

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The petition for writ of certiorari refers to the opinions of the Dauphin County Court and the Pennsylvania Supreme Court, the grounds upon which jurisdiction is invoked, and the pertinent constitutional and statutory provisions. It also sets forth a summary statement of the matter involved and states the questions presented.

I. STATEMENT OF THE CASE

There is no dispute as to the facts in the case which have been stipulated (Stipulation of Facts 44a-55a).

The Curtis Publishing Company of Pennsylvania was incorporated under the laws of the Commonwealth of Pennsylvania in December, 1921, and during the year 1942 was engaged in business subject to corporate net income tax by the Commonwealth under the provisions of the Corporate Net Income Tax Act of May 16, 1935, P. L. 208, as reenacted and amended by the Act of May 29, 1941, P. L. 62 (44a, 45a).

On April 5, 1943, the company filed its corporate net income tax return for the calendar year 1942 wherein the tax estimated by it to be due was "None", based upon the net income as returned to the Federal Government. In this report the taxpayer took no deduction on account of interest received on United States obligations issued after March 1, 1941 (Commonwealth's Exhibit No. 1, 154a).

On November 3, 1943, the company filed with the Department of Revenue a Report of Change of net income for 1942, wherein corporate net

income tax was estimated by it to be due the Commonwealth in the amount of $6,066.03, which sum was paid to the Department of Revenue (Commonwealth's Exhibit No. 2, 155a).

This Report of Change filed by the taxpayer with the Department of Revenue reported that the company's adjusted net income as returned to, and ascertained by the Federal Government increased from $886,280.53 to $1,033,923.16 (Commonwealth's Exhibit No. 2, 155a).

The company's net income, subject to allocation by the use of the appropriate fractions, was reported to be in the amount of $125,713.37. This figure was computed by the taxpayer as follows:

"Adjusted net income per 'Report of Change' in income filed November 3, 1943, on which the settlement appealed from is based		$ 1,033,923.16
Deductions allowed by Pennsylvania Corporate Net Income Tax Act:		
Federal taxes	$149,644.11	
Dividends	758,565.68	908,209.79
Net income tax base		$ 125,713.37"

(Commonwealth's Exhibit No. 2, 155a).

Included in the taxpayer's net income as returned to and ascertained by the Federal Gov-

ernment was an item in the amount of $75,389.62, representing interest on United States obligations issued subsequent to March 1, 1941 (Commonwealth's Exhibit No. 1, 154a). In the Report of Change, the taxpayer took no deduction on account of this interest received on United States obligations issued after March 1, 1941 (Commonwealth's Exhibit No. 2, 155a).

On December 27, 1945, the Department of Revenue settled the company's 1942 corporate net income tax, which settlement was approved by the Department of the Auditor General on December 27, 1945. This settlement, based upon facts appearing in both the original report and the Report of Change, determined the taxpayer's tax liability to be in the amount of $6,367.67 (Commonwealth's Exhibit No. 1, 154a). The difference between $6,006.03, as reported by the taxpayer, and $6,367.67, settled by the fiscal officers, was due to a correction in the gross receipts fraction, and is not here in question (51a).

In this settlement of the company's net income tax base for purposes of the Pennsylvania corporate net income tax, the fiscal officers of the Commonwealth did not deduct the item of $75,389.62, representing interest on United States securities issued after March 1, 1941, from the company's net income as returned to, and ascertained by the Federal Government (Commonwealth's Exhibit No. 1, 154a).

On February 26, 1946, the taxpayer filed a Petition for Resettlement with the Department of Revenue, and that petition was refused on May 3, 1946 (18a, 42a).

On June 17, 1946, the taxpayer filed a Petition for Review with the Board of Finance and Revenue, and that petition was refused on July 11, 1946 (19a, 42a).

On ~~July 17~~ Aug 2, 1946, the taxpayer filed ~~a Petition~~ its ap- peal in the Court of Common Pleas of Dauphin County from the settlement and action of the Board of Finance and Revenue (3a, 88a). A stipulation was filed waiving a jury trial as provided by the Act of 1874, P. L. 109 (32a, 88a). At the hearing testimony was taken and submitted in the form of an agreed stipulation of facts (37a, 44a). Argument was heard and the court in due course rendered its decision, and entered a judgment nisi in favor of the taxpayer in the amount of $3,818.66 (140a). Exceptions to the lower court's rulings on requests for conclusions of law, the conclusions of law, and the judgment nisi were duly filed by the Commonwealth (141a). The court by an order overruled each of the Commonwealth's exceptions and directed that judgment be entered in favor of the taxpayer and in accordance with its prior opinion (153a). Upon appeal to the Supreme Court of Pennsylvania, the judgment of the lower court was affirmed.

II. ARGUMENT

1. The nature of the Corporate Net Income Tax Act of May 29, 1941, P. L. 62, as determined by the court of last resort in Pennsylvania.

Section 3 of the Corporate Net Income Tax Act of May 29, 1941, P. L. 62, reenacting and amending the Act of May 16, 1935, P. L. 208, provides:

> "Every corporation shall be subject to, and shall pay **for the privilege of doing business in this Commonwealth,** or having capital or property employed or used in this Commonwealth * * * **a State excise tax** * * * at the rate of seven per centum per annum upon each dollar of the **net income** of such corporations during the calendar year(s) * * * one thousand nine hundred forty-two * * *." (Boldface ours)

It is now well established under the decisions of the Supreme Court construing the nature of the Pennsylvania corporate net income tax, that it is **an excise tax for the privilege of doing business in the Commonwealth measured by the net income as returned to and ascertained by the Federal Government.**

Turco Paint & Varnish Co. v. Kalodner, 320 Pa. 421, 423, 429 (1936);

Commonwealth v. Warner Bros. Theatres, Inc., 345 Pa. 270, 271 (1942);

Commonwealth v. Bayuk Cigars, Inc., 345 Pa. 348, 350, 351 (1942);

Commonwealth v. Electrolux Corporation, 59 Dauph. 412 (1948), affirmed per curiam, 362 Pa. 333 (1949).

Even the most cursory examination of the cited cases makes it abundantly clear that the Pennsylvania corporate net income tax is (1) neither a property tax on net income; (2) nor a tax on the privilege of investing in United States obligations; (3) nor a tax on the privilege of doing business measured exclusively by income from investments in United States obligations.

The true nature of the tax is precisely described by the Supreme Court of Pennsylvania in Commonwealth v. Warner Bros. Theatres, Inc., supra, at pages 271, 272, in the following distinguishing language:

> "At the outset, it is to be observed that we are not considering an income tax, but an excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the Federal Government. When this situation

is borne in mind, the doubts as to the legality of the tax suggested by appellant disappear."

This principle was recognized by the lower court even in the instant case, 59 Dauph. 430, at page 439 (126a), in the following language:

> "It must not be overlooked that under the Pennsylvania Corporate Net Income Tax Act there is no direct tax imposed for the privilege of doing business in Pennsylvania as measured by the net income." (Citing cases).

It was also recognized in the instant case by the Supreme Court of Pennsylvania in its decision affirming the holding of the lower court, 363 Pa. 299, 312.

Section 2 of the Act defines net income as follows:

> " 'Net Income.' 1. In case the entire business of the corporation is transacted within this Commonwealth, net income for the calendar year or fiscal year as returned to, and ascertained by the Federal Government, subject, however, to any correction thereof, for fraud, evasion, or error as finally ascertained by the Federal Government: Provided, That additional deductions shall be allowed from net income on account of any

> Federal taxes paid during such calendar or fiscal year for the preceding calendar or fiscal year, or accrued during such calendar or fiscal year for such year, as the case may be, and on account of any dividends received from any other corporation: * * *
>
> "2. In case the entire business of any corporation, other than a corporation engaged in doing business as an insurance or surety company, is not transacted within this Commonwealth, the tax imposed by this act shall be based upon such portion of the net income of such corporation for the fiscal or calendar year, as defined in clause one hereof, as may be determined by allocations and apportionments made as follows: * * *."

From a reading of the plain language of Section 2, it is evident that the net income as ascertained by the Federal Government is the base upon which the Pennsylvania tax is measured; that as a base it is unvarying; and, that the Pennsylvania act "only takes the net income fixed by it (the Federal Government) as the base for the excise privilege tax levied by the Commonwealth": Commonwealth v. Warner Bros. Theatres, Inc., supra, page 272.

Such was the plain and proper construction placed upon Section 2 by the Supreme Court of Pennsylvania in the last cited case. There the

Court stated at pages 271, 272, (repeating in part and continuing with the excerpt previously quoted):

> "At the outset, it is to be observed that we are not considering an income tax, but an excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the Federal Government. When this situation is borne in mind, the doubts as to the legality of the tax suggested by appellant disappear. Net income as ascertained is the base upon which the tax is measured, not the tax itself. **How it was fixed by the Federal authorities is of no concern to the taxing officers of the Commonwealth nor to its statute.** The rate of the income tax may vary, or the method of its computation, but as a base, it is unvarying." (Boldface ours)

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2. A corporate franchise or privilege tax measured by a base which includes in part interest on United States obligations does not violate either Article VI, Clause 2, and/or Article I, Section 8, Clause 2, of the United States Constitution.

A basic question involved in this petition concerns the extending of the field within which the

doctrine of intergovernmental tax immunity may be given operative effect.

The doctrine of intergovernmental tax immunity rests ultimately upon implication, and not upon explicit provisions of the Constitution. Both early and recent cases of the Supreme Court of the United States have recognized that the superstructure of intergovernmental tax immunity is constructed upon the foundation stone of implication.

Early acknowledgment of this proposition was made in the case of **Collector v. Day,** 11 Wall. 113 (1871), wherein the Supreme Court of the United States said, at page 127:

> "* * * It is admitted that there is no express provision in the Constitution that prohibits the general government from taxing the means and instrumentalities of the states, nor is there any prohibiting the states from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self preservation; * * *"

A more recent recognition was given this proposition in the concurring opinion of Mr. Justice Frankfurter in **Graves v. N. Y. ex rel. O'Keefe,** 306 U. S. 466 (1939), stating at page 488:

> "For one hundred and twenty years this Court has been concerned with claims of immunity from taxes imposed by one authority in our dual system of government because of the taxpayer's relation to the other. The basis for the Court's intervention in this field has not been any explicit provision of the Constitution. * * *"

In the present case we are concerned with one side of the coin of reciprocal government immunity—the implied restriction upon the taxing powers of a State in so far as it touches upon certain obligations of the United States or the interest therefrom.

Whatever immunity from State taxation is extended to United States obligations, or interest therefrom, rests upon implication derived from Article VI, Clause 2, and Article I, Section 8, Clause 2, of the Constitution of the United States. The former establishes the constitution and the laws of the United States as the supreme law of the land; the latter provides that "Congress shall have power * * * to borrow money on the credit of the United States."

The immunity that has been implied from these provisions of the Constitution has been consistently applied to those cases where a State sought to impose a **direct** tax upon United States obligations or the interest derived therefrom.

But on no occasion has this immunity been over extended to cases involving a bona fide State franchise or privilege tax which included in its measure, in part at least, otherwise exempt United States obligations or interest therefrom.

The distinction between a direct tax upon United States obligations or interest therefrom and an excise or privilege tax which merely involves such obligations or interest in the measure has been made even in cases involving Federal taxes. See **Flint v. Stone Tracy Co.**, 220 U. S. 107, 171 (1911), involving a Federal corporate excise tax measured by net income including United States bonds; **Phipps v. Commissioner of Internal Revenue,** 91 F. (2d) 627 (1937), involving a Federal gift tax and its application to United States bonds.

The Supreme Court of the United States sustained as valid State corporate franchise or privilege taxes measured by net income which includes interest on United States obligations:

Home Ins. Co. v. New York, 134 U. S. 594, 10 S. Ct. 593, 33 L. Ed. 1025 (1890);

Educational Films Corp. v. Ward, 282 U. S. 379 (1931);

Tradesmen's National Bank v. Oklahoma Tax Comm., 309 U. S. 560, 60 S. Ct. 688, 84 L. Ed. 947 (1940);

Cf. also **Pacific Co. v. Johnson,** 285 U. S. 480, 490 (1932);

People of State of New York ex rel. Northern Finance Corp. v. Lynch, 290 U. S. 601 (1933);

N. J. Realty v. Div. of Tax Appeal, U. S. , 10 U. S. Supreme Court Bulletin, 463, 470 and Footnote 6 (February 6, 1950);

Also **31 Ops. Att'y Gen. (U. S.)** 125, 126 127.

It is now settled beyond question that the construction placed by the Supreme Court of Pennsylvania upon the Corporate Net Income Tax Act of May 16, 1935, P. L. 208, as amended, has determined the tax to be, not a tax imposed on property, but an "excise tax for the privilege of doing business in the Commonwealth, based upon net income as returned to and ascertained by the Federal Government", wherein the "net income as ascertained is the base upon which the tax is measured not the tax itself": Commonwealth v. Warner Bros. Theatres, Inc., supra. Cf. also, Turco Paint and Varnish Co. v. Kalodner, supra.

The taxpayer's contentions are basically founded upon an over-extension of the doctrine of reciprocal governmental immunity. Not being founded expressly upon provisions of the

Constitution of the United States, the doctrine rests upon judicial implication. The current attitude of the Supreme Court of the United States, if we may presume to appreciate it, would appear to reflect a definite waning of implied governmental immunities in view of current interrelationship between the functions of the Federal Government and those of the States.

Graves v. N. Y. ex rel. O'Keefe, supra, involved the New York income tax imposed on the receipt of salary by a resident of New York as an examining attorney for the Federal Home Owners' Loan Corporation. The Court, in rejecting the taxpayer's claim for refund, stated at page 486:

> "In no case is there basis for **the assumption** that any such tangible or certain economic burden is imposed on the government concerned as would justify a court's declaring that the taxpayer is clothed with the implied constitutional tax immunity of the government by which he is employed. That assumption made in Collector v, Day, supra, and in New York ex rel. Rogers v. Graves, supra, is contrary to the reasoning and to the conclusions reached in the Gerhardt case and in Metcalf & Eddy v. Mitchell, supra; Group No. 1 Oil Corp. v. Bass,

> 283 U. S. 279; James v. Dravo Contracting Co., supra; Helvering v. Mountain Producers Corp., supra; McLoughlin v. Commissioner, 303 U. S. 218. **In their light the assumption can no longer be made.** Collector v. Day, supra, and New York ex rel. Rogers v. Graves, supra, are overruled so far as they recognize an implied constitutional immunity from income taxation of the salaries of officers or employees of the national or a state government or their instrumentalities." (Boldface ours)

If, in following the Supreme Court of the United States, **no assumption** were to be made in the instant case of a tangible or economic burden on the Federal Government's borrowing powers, there would be equal justification in refusing to declare that "the taxpayer is clothed with the implied constitutional tax immunity of the government" in whose obligations he has invested. Particularly so where, as here, no proof whatever was offered or produced to establish such burden.

Again, in **Oklahoma Tax Commission v. Texas Co.**, 336 U. S. 342 (1949), the Supreme Court, holding that a lessee of mineral rights and restricted Indian lands is not immunized against payment of State gross production

taxes and State excise taxes on petroleum produced from such lands, said at page 352:

> "It is true that this Court's more recent pronouncements have beaten a fairly large retreat from its formerly prevailing ideas concerning the breadth of so-called intergovernmental immunities from taxation, a retreat which has run in both directions—to restrict the scope of immunity of private persons seeking to clothe themselves with governmental character from both federal and state taxation. The history of the immunity, by and large in both aspects, represents a rising or expanding curve, tapering off into a falling or contracting one."

And further on page 365:

> "* * * True intergovernmental immunity remains for the most part. But, so far as concerns private persons claiming immunity for their ordinary business operations (even though in connection with governmental activities), no implied constitutional immunity can rest on the merely hypothetical interferences with governmental functions here asserted to sustain exemption. * * *"

3 The Pennsylvania corporate net income tax measured by "net income as returned to and ascertained by the Federal Government" is neither "discriminatory", "hostile" nor "burdensome".

It is the taxpayer's contention that the Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, as applied by the fiscal officers of the Commonwealth violates Article I, Section 8, Clause 2, of the Constitution of the United States (providing that "Congress shall have power * * * to borrow money"), and Article VI, Clause 2 (establishing the Constitution of the United States the supreme law of the land) because the Pennsylvania Act is discriminatory.

The contention is based on the ground that the measure of the tax takes as its base the "net income as returned to and ascertained by the Federal Government" which net income as ascertained by the Federal Government includes interest on United States obligations issued after March 1, 1941, but does not include interest on State and municipal obligations.

The most minute reading of the Act fails to reveal any mention of State or municipal obligations; nor is any reference made to interest derived therefrom; nor, for that matter, is any

mention or reference made to United States obligations or interest derived therefrom. It is obvious that there is at least no express statutory discrimination among such obligations on the face of the Pennsylvania Act. It is likewise apparent that had the Legislature intended to give special treatment to the interest on a particular class of obligations they well knew how to provide for it. However, the Act itself, as stated in Commonwealth v. Warner Bros. Theatres, Inc., supra, "only takes the net income fixed by it (the Federal Government) as the base for the excise privilege tax levied by the Commonwealth". There is nothing in the language of the Act to require or authorize the fiscal officers of the Commonwealth to make an adjustment of the net income by deducting from the Federal base (as Respondent would have them do) the interest derived from certain United States obligations.

Secondly, the entire record may be searched from beginning to end, yet nowhere does it appear that any evidence was adduced, or even offered, to prove the existence of **actual or factual discrimination** as between United States obligations on the one hand and State and municipal obligations on the other. The burden of establishing the facts to support the allegation of discrimination rests squarely upon the taxpayer:

Willcuts v. Bunn, 282 U. S. 216, 230, 231 (1931);

Welch v. Henry, 305 U. S. 134, 146 (1938);

Commonwealth v. Union National Bank of Reading, 51 Dauph. 362, 370, 371, 373, 374 (1940);

Commonwealth v. City National Bank, Philadelphia, Pa., 52 Dauph. 87, 101, 104 (1941).

In reality the taxpayer's complaint is based on the fact that the taxing officers **did settle** the tax precisely as required on the very face of the report. The company's contention actually asserts that they should not have done so, but should have interpolated an adjustment of net income by way of a deduction of interest on certain United States bonds, despite the absence of any statutory authority to do so. Thus, the alleged discrimination is not bottomed on the settlement of the tax on the face of the tax report, but on the omission of the fiscal officers to make an additional adjustment not provided for either by the Act or the form of the tax report itself, nor, for that matter even claimed in the taxpayer's own tax reports (Commonwealth's Exhibits Nos. 1, 2, 154a, 155a).

The contention of the taxpayer that the settlement of tax in the instant case had the effect

of discriminating against its ownership of United States obligations, is fully answered even by very early decisions of the Supreme Court of the United States.

Thus, in Home Insurance Co. v. New York, supra, page 612, it was said:

> "This doctrine of the taxability of the franchises of a corporation **without reference to the character of the property in which its capital stock or its deposits are invested** is sustained by the judgments in Society for Savings v. Coite, 6 Wall. 594, and Provident Institution v. Massachusetts, 6 Wall. 611, which were before this court at December Term, 1867. * * *"
> (Boldface ours)

And in **Society for Savings v. Coite,** 6 Wall. 594, 18 L. ed. 907 (1868), pages 606, 607, it was said:

> "Nothing can be more certain in legal decision than that the privileges and franchises of a private corporation, all trades and avocations by which the citizens acquire a livelihood, may be taxed by a state for the support of the state government. Authority to that effect resides in the state independent of the Federal government, **and is wholly unaffected by the fact that**

the corporation or individual has or has not made investment in Federal securities. Osborn v. U. S. Bank, 9 Wheat. 859." (Boldface ours)

Hence the choice and character of taxpayer's investments are entirely irrelevant where the tax in issue is one imposed for the privilege of doing business and not upon the property or income as such.

All corporations in like circumstances to the taxpayer in the instant case are given like treatment taxwise: Turco Paint and Varnish Co. v. Kalodner, supra.

To contend, as the taxpayer does, that the alleged discriminatory effect of the Pennsylvania Act is derivative from the adoption of the Federal base not only seeks to account for a charge which it has failed in fact to prove, but also carries with it the admission that the discrimination, if any, is not the result of any "unfriendly", "hostile", or "invidious" legislation on the part of the Commonwealth of Pennsylvania.

The Corporate Net Income Tax Act of May 16, 1935, P. L. 208, and its various reenactments and amendments, including the Act of May 29, 1941, P. L. 62, were not passed as acts of unfriendly discrimination. For only since the Public Debt Act of 1941 were these Federal obli-

gations and income therefrom made subject to Federal taxation.

Any burden to the taxpayer by reason of receiving income from United States obligations issued after March 1, 1941, is, in so far as the State legislation is concerned, purely casual and incidental.

In this connection the principle of law is established by Educational Films Corp. v. Ward, supra, 388, 389; Pacific Co. v. Johnson, supra, 493-495; Tradesmen's National Bank of Oklahoma City v. Oklahoma Tax Comm., supra, 564-566.

In the Pennsylvania Corporate Net Income Tax Act there is **not**, as there was in **Miller v. Milwaukee**, 272 U. S. 713 (1927), an "exclusion from the measure of the tax of all income except from Federal bonds"; and unlike that case there was no attempt by Pennsylvania "to measure the tax by exempt income while excluding from the measure all taxable income".

Rather like California, in Pacific Co. v. Johnson, supra, and like Oklahoma, in Tradesmen's National Bank case, supra, Pennsylvania in its legislation "has indulged in no reversal of policy so far as the measurement of the franchise tax is concerned, and in no discrimination

either in favor of or against tax-exempt income."

Thus, a State tax statute is "discriminatory and hostile" within the meaning of the United States Supreme Court decision, when its passage evidences a change or reversal of legislative policy directed toward placing the burden upon theretofore exempt property or income:

> See Miller v. Milwaukee, supra;
>
> **Macallen Co. v. Massachusetts,** 279 U. S. 620 (1929).

On the other hand, a tax statute is neither "discriminatory" nor "hostile" merely because the unintended consequence of the legislative act directed toward taxable subject matter may place a casual or incidental burden on tax exempt property or income: Flint v. Stone Tracy Co., supra; Educational Films Corp. v. Ward, supra; Tradesmen's National Bank of Oklahoma City v. Oklahoma Tax Commission, supra; Pacific Co. v. Johnson, supra.

Section 4 of the Public Debt Act of February 19, 1941 (c. 7, Sec. 4, 55 Stat. 9) provides as follows:

> "Sec. 4. (a) Interest upon, and gain from the sale or other disposition of, obligations issued on or after the effective date

of this Act by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations shall not have any special treatment, as such, under Federal Tax Acts now or hereafter enacted; * * *".

The passage of this Act is further evidence of the attitude of Congress that the withholding at least of Federal tax immunity from interest on United States obligations will not impair its borrowing power; and thus supports the view underlying its previous approval of the inclusion of such interest in the measure of a State excise tax imposed for the privilege of doing business within the State. In neither case, Congress feels, is the borrowing power of the Federal Government impaired.

With respect to the charge of hostile discrimination in favor of interest from State or municipal obligations, the taxpayer's complaint is grounded on the Legislature's **omission to include** such income in the measure of tax, immediately following the passage by Congress of the Public Debt Act of 1941. While it may be claimed that a reversal or change in legislative policy through subsequent enactments results in discrimination (See Pacific Co. v. Johnson, supra), here it is claimed, in effect, that a re-

versal or change in legislative policy was effectuated through omission to enact.

Commonwealth v. Schuylkill Trust Co., 38 Dauph. 22, 315 Pa. 429, 296 U. S. 113, involved a tax on the shares of stockholders in a trust company under the Act of June 13, 1907, P. L. 640, as amended by the Act of July 11, 1923, P. L. 1071, by the Act of May 7, 1927, P. L. 853, and the Act of April 25, 1929, P. L. 675.

The case came before the Supreme Court of the United States on two occasions—296 U. S. 113 (1935), and 302 U. S. 506 (1938). Mr. Justice Roberts wrote the majority opinion (three justices dissenting) in the first case, and the opinion of the Court without dissents in the second case.

In the earlier case, Mr. Justice Roberts, without determining the nature of the tax, had stated at page 119, citing cases:

> "**If** the tax is one truly upon that independent property evidenced by the ownership of a share of corporate stock its collection does not discriminate against United States securities." (Boldface ours)

In the latter case, Mr. Justice Roberts, finally determining the nature of the tax, stated at page 513:

"* * * We are of opinion that the tax is one upon the shares as such and not upon the assets of the company.

"Fourth. The State need not have made any exemption or concession in taxing the property in the shares on account of value therein reflected from the company's ownership of obligations of the government or its instrumentalities other than national bank stock. (Citing same cases)."

Nevertheless, in the earlier case, a majority of this Court held that the shares tax as settled against the taxpayer discriminated against Federal obligations. The source of this "discrimination" was attributed to the legislative action of the State in excluding in the computation of net assets the value of shares in Pennsylvania corporations which were already taxed or relieved from tax by State law, while providing for no corresponding deduction on account of Federal securities.

The legislative action by the State referred to was embodied in two amendments to the original Act of 1907, supra. The amendment of 1923, supra, excluded shares of stock of Pennsylvania corporations **already taxed**; the amendment of 1927, supra, went further and excluded shares of stock of Pennsylvania corporations **relieved** from tax.

Obviously, in the absence of these amendments, and under the original Act of 1907, there would have been no exemptions, and hence no discrimination. The two statements of Mr. Justice Roberts, in each of the separate opinions, would be easily reconcilable and conclusive of the issue.

While a majority of this Court found discrimination by reason of the effect of the exemption amendments, the dissenters found no "unfriendly discrimination" because the purpose of exemptions was "to avoid double taxation or something akin thereto".

Despite this difference of opinion between majority and minority as to whether the effect of the exemption amendments was discriminatory, both recognized the basic fact that there had been some affirmative legislative action by Pennsylvania changing the policy with respect to calculation of the taxable value of shares in trust companies.

In summarizing the distinction between the Schuylkill case and the instant case, it may be pointed out (1) the Schuylkill case involved a **property tax** on shares in hands of shareholders of trust companies; the instant case involves an excise tax for a corporation's privilege of doing business in the Commonwealth; (2) the Schuyl-

kill case involved affirmative legislative action granting exemptions which reflected a change in policy and resulting in what a majority of a divided Court termed "discrimination"; in the instant case, there was no change in Pennsylvania legislation reflecting a reversal of policy, the only legislative change being on the part of the Federal Government which enacted the Public Debt Act of 1941.

Finally, it may be pointed out that the line of cases more appropriately relevant than the Schuylkill case to the issue in the instant case, are decisions that both preceded and followed that case. The authorities referred to and discussed earlier in this brief are: Home Ins. Co. v. New York, supra, (1890); Flint v. Stone Tracy Co., supra, (1911); Educational Films Corp. v. Ward, supra, (1931); Pacific Co. v. Johnson, supra, (1932); Tradesmen's National Bank v. Oklahoma Tax Comm., supra, (1940).

4. Summary

The position of the Commonwealth of Pennsylvania, petitioner, in the instant case may be summarized as follows:

1. The Pennsylvania Corporate Net Income Tax Act of May 29, 1941, P. L. 62, is

not a property tax; it is not a tax on the privilege of investing in United States obligations; nor is it a tax on the privilege of doing business measured exclusively by income from investments in United States obligations. It is, as construed by the court of last resort in Pennsylvania, **an excise tax on the privilege of doing business in the Commonwealth measured by the net income as returned to and ascertained by the Federal Government.**

Accordingly, the Pennsylvania Act only takes the net income fixed by the Federal Government as the base for the excise privilege tax levied by the Commonwealth, and it is of no concern to the taxing officers of the Commonwealth, nor to its statute, how the net income was fixed by the Federal authorities. Hence, no variance or modification of the Pennsylvania tax base is permitted to the taxing officers of the Commonwealth in computing corporate net income tax liability beyond such adjustment as may be authorized by express statutory language providing therefor.

2. Generally, no corporate franchise or privilege tax measured by a base which includes in part interest on United States obligations violates thereby either Article VI,

Clause 2, and/or Article I, Section 8, Clause 2, of the United States Constitution. In like manner, the Pennsylvania corporate net income tax is not in violation of these provisions, the reflection of the income derived from United States obligations issued after March 1, 1941, in the measurement of the tax not being a tax on that income, but being merely incidental to the operation of the formula which determines the value of the privilege of doing business in this Commonwealth.

3. The Pennsylvania corporate net income tax, measured by "net income as returned to and ascertained by the Federal Government", is neither discriminatory, hostile nor burdensome. In so far as income from State and municipal obligations is concerned, there is nothing on the face of the Act that supports a charge of discrimination. There is no evidence whatsoever to establish actual discrimination, or discrimination in fact, in favor of income from State and municipal obligations and against income from United States obligations.

There has been no Pennsylvania legislation enacting a reversal of policy so far as the measurement of the tax is concerned so

as to discriminate either in favor of, or against, tax-exempt income. The measurement of the tax, in so far as income from Federal, State or municipal obligations is concerned, has in fact remained unaltered by any Pennsylvania legislation.

Accordingly, it is respectfully submitted that the record in this case presents an important Federal question of substance which has been decided by the Supreme Court of Pennsylvania in a way probably not in accord with the decisions of this Court, and that the petition for review on writ of certiorari be granted.

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